MAY 6 1974
MICHAEL RODAK, JR.

IN THE

Supreme Court of the United States

OCTOBER TERM, 1973

NO. 73-1657

ESTATE OF JOSEPH M. MEADE, DECEASED, FIRST NATIONAL BANK OF FLORENCE, EXECUTOR, and HAZEL B. MEADE,

Petitoners,

v.

COMMISSIONER OF INTERNAL REVENUE

WILLIAM S. and ELIZABETH KING,

Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

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ATTORNEY FOR PETITIONERS

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IN THE
SUPREME COURT OF THE UNITED STATES

October Term _____

NO. _____

ESTATE OF JOSEPH M. MEADE, DECEASED
FIRST NATIONAL BANK OF FLORENCE, EXECUTOR,
and HAZEL B. MEADE,
Petitoners,

v.

COMMISSIONER OF INTERNAL REVENUE

WILLIAM S. and ELIZABETH KING,
Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE

PETITION FOR A WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

The petitioners pray that a writ of certiorari issue to review the opinion of the United States Court of Appeals, Fifth Circuit, rendered in this case on February 7, 1974.

OPINIONS BELOW

The opinion of the Court of Appeals is attached, Appendix A. The opinion denying a motion for rehearing is attached, Appendix A. The opinion of the Tax Court is attached,

Appendix B, and is reported at 31 TCM 935 (1972).

JURISDICTION

The order of the United States Court of Appeals for the Fifth Circuit denying the motion for a rehearing was entered on the 5th day of March, 1974. The jurisdiction of this Court is invoked under 28 U.S.C. Sec. 1254(1).

QUESTION PRESENTED

Whether, under the origin of litigation rule as established by this Court, litigation expenses of collecting a claim received in a corporate liquidation retain their capital or ordinary character through the corporate liquidation, or must relate solely to the corporation liquidation.

STATEMENT OF FACTS

The facts in this case were fully stipulated. The taxpayers were the sole shareholders of the Terrace Corporation which was liquidated on February 15, 1965. Included in the liquidating distribution was a claim against Kaiser Aluminum Company for violation of the federal antitrust laws. After the liquidation, the individual stockholders retained counsel to pursue, on their behalf, the former claim of the Terrace Corporation against Kaiser. The case was settled in 1966 with Kaiser paying $900,000 to the stockholders. Also, in 1966 the stockholders paid $320,993.67 in legal fees and litigation expenses which they had incurred in collecting this claim.

In their 1966 tax returns, the taxpayers reflected the $900,000 as long-term capital gain as additional proceeds from the liquidation of their corporation under Sec. 331.[1] Also in their 1966 tax return, the taxpayers claimed the $320,993.67 as expenses incurred in the collection of the income under Sec. 212(1). The Commissioner of Internal Revenue issued a deficiency for the taxable year, 1966, in the amount of $29,991.37 for Meade and $65,221.26 for King, ruling that the legal fees and expenses should relate solely to the liquidation of the Terrace Corporation and should be offset against the capital gain proceeds. The taxpayers filed a petition with the Tax Court for a redetermination of their deficiencies.

The Tax Court, in a memorandum decision, 31 TCM 935(1972), Appendix B, held that this case was controlled by the Tax Court's previous decision in Otto C. Doering, Jr., 39 T.C. 647(1963) affd. 335 F.2d 738 (C.A. 2nd Cir. 1964) and held that legal expenses paid to collect income are properly deductible under Section 212, even though the income collected is capital gain, and held that under this Court's decision in United States v. Gilmore, 372 U.S. 39, 83 S.Ct. 623, 9 L.Ed. 2d 570(1963); Woodward v. Commissioner, 397 U.S. 572, 90 S.Ct. 1302, 25 L.Ed. 2d 577 (1970); and United States v. Hilton Hotels Corporation, Inc., 397 U.S. 580, 90 S.Ct. 1307, 25 L.Ed. 2d 585 (1970), the origin of this litigation related back to the original wrongful act of Kaiser and not to the corporate liquidation.

1/ All references are to the 1954 Internal Revenue Code.

The Fifth Circuit Court of Appeals reversed and held in its opinion, Estate of Meade v. Commissioner, No. 73-1456, Appendix A, that in applying the origin standard to the facts of this case, the claim against Kaiser, as it rested in the hands of these taxpayers, had its origin in the process of the disposition of their Terrace stock, and that the expenses of collecting the claim relate back to the corporate liquidation.

REASONS FOR GRANTING THE WRIT

As reported in The Journal of Taxation,[2] the Tax Court holdings in Estate of Meade, Appendix B, and its companion case, Arthur H. DuGrenier, Inc., 58 T. C. 931 (1972), extended the origin of litigation rule, as established by this Court, to situations arising out of corporate liquidations. As stated in this article, the Tax Court held that, under the origin of litigation rule, the deductibility of expenses in collecting a claim received in a corporate liquidation relate to the operations of the corporation prior to the liquidation. Since the taxpayers' corporation would have been allowed an ordinary deduction for the legal fees involved, then the taxpayers were entitled to an ordinary deduction for their litigation expenses in collecting the claim.

The establishment of a rule of law for the proper deduction of litigation expenses has been an important question for this Court. As stated in a recent article, "Developing Patterns In The Deduction of Professional Fees", 50 TAXES 771 (1972), "The importance,

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2/ "Tax Court Rules on Litigation Fees in Liquidation," 37 The Journal of Taxation 382, December, 1972.

if not the complexity, of the area is indicated by the eleven Supreme Court decisions concerning the deduction of professional fees, six of which have been decided in the last ten years."

The major rule which has been established in this area is the origin of litigation rule which was expressed in this Court's opinion in United States v. Gilmore, supra. In that case, the Court held that litigation expenses would be deductible or nondeductible based upon the "origin" and the character of the claim litigated. If the claim originated out of the profit-seeking activities of the taxpayer, it would be deductible. If the claim arises out of a nonprofit-seeking activity, as was the case in Gilmore, then the expenses of resisting the claim are nondeductible.

This principle was further modified by this Court in Woodward v. Commissioner, supra, and its companion case, United States v. Hilton Hotels Corporation, supra, which held that the characterization of litigation expenses as ordinary or capital will be controlled by the event which created the original claim litigated.

I

The Opinion Of The Fifth Circuit Court Of Appeals Is In Clear Conflict With The Previous Rulings Of This Court.

In United States v. Hilton Hotels Corporation, supra, the principle of the origin of litigation rule was further modified by the holding of this Court that a claim retains its character through the liquidation of a corporation by statutory merger. As

stated by this opinion, 90 S.Ct. 1307, 1309, claims "retained their capital or ordinary character through the merger and so did the expenditures for fixing the amount of those debts." (emphasis added)

In the Hilton case, the claim litigated by Hilton Hotel Corporation was the obligation of the Waldorf-Astoria Corporation (which was liquidated into Hilton by the merger) to purchase the stock of the dissenting stockholders of Waldorf. This Court very clearly held that the character of the claim as it originated with Waldorf passed through the merger and retained its original character in the hands of Hilton. This Court did not hold that the origin of the claim, as it rested in the hands of Hilton, was controlled by the corporate liquidation and merger of Waldorf into Hilton.

There is apparently some confusion as to whether the capitalization of the expenses in the Hilton case related to the statutory merger of Waldorf into Hilton or to the obligation of Waldorf prior to the merger. Either holding would have required the expenses to be capitalized. The Fifth Circuit apparently interpreted the Hilton case as holding that the capitalization requirement resulted solely from the merger. A careful reading of this Court's opinion shows very clearly that the capitalization requirement of these expenses to Hilton related to the prior obligation of Waldorf to acquire the stock, and that this characterization passed through the merger.

The facts in the instant case are almost identical to the Hilton case. The claim was created by the original wrongful act of Kaiser against the Terrace Corporation for the violations of antitrust laws. This

claim was distributed to the taxpayers in liquidation of the corporation. The origin of litigation under the Hilton rule would be the original wrongful act of Kaiser against the Terrace Corporation, and the character of this litigation would retain its capital or ordinary character through the corporate liquidation.

The Tax Court, in applying the origin of litigation rule (as established by this Court) to the facts of this case, held Appendix B, p. 9 of original opinion that the origin "test requires inquiry into the origin and character of the claim which is the subject of litigation . . . . The character of the claim is, therefore, collection of income. Its origin was the alleged violations of the antitrust laws by Kaiser Aluminum. By 'origin' of the claim, we do not construe that to mean how the claim was acquired by the taxpayers who pursue it, but instead we conclude that it means the event which gave rise to the claim."

The Fifth Circuit Court of Appeals, in applying the same origin of litigation rule to the same facts, held, Appendix A, p. 787 of original opinion that in "Applying the 'origin' standard to the facts before us, we are convinced that the antitrust claim against Kaiser-Aluminum as it rested in the hands of these taxpayers-- had its origin in the process of the disposition of their stock in Terrace Corporation."[3] The decision of the Tax

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3/ It is unfortunate that this case involves the distribution of a claim which did not have an ascertainable value. It is apparent that this had a strong bearing on the Fifth Circuit's opinion in this case. The taxability of claims or other assets which do not have an ascertainable value is not

(continued on next page)

Court and the Fifth Circuit are, therefore, directly contradictory to each other as to the application of the origin of litigation rule of this Court.

The Fifth Circuit opinion seems to be in direct conflict with this Court's express language in United States v. Hilton Hotel Corporation, supra. The Tax Court's opinion follows almost the exact language of the Hilton case and seems to be the proper interpretation of the origin of litigation rule as established by this Court.

II

The Opinion Of The Fifth Circuit Court Of Appeals Is In Conflict With Other Circuit Courts of Appeals

The decision of the Fifth Circuit Court of Appeals and the cases cited therein reflect the conflicts in the various Circuit Courts of Appeals as to the proper deduction of litigation expenditures incurred in relationship to corporate liquidations. These conflicts seem to be unreconcilable and need to be resolved by this Court.

The conflicts are found in two areas of corporate liquidations. The first area of conflict (which is reflected by the facts in

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3/ (Continued)
in conflict. Burnet v. Logan, 283 U.S. 404, 51 S.Ct. 550, 75 L.Ed. 1143 (1931). This issue needs to be separated from the issue of determining the proper deduction of the litigation expenses to collect the claim. The same rules with regard to the deductibility of litigation expenses would seem to be applicable whether or not the claim received had an ascertainable value.

this case) is whether, under the origin of litigacion rule, the litigation expenses, incurred by former stockholders against third parties to collect claims received in corporate liquidations, relate to the original act which created the claim, or must be related solely to the corporate liquidation. The second area of conflict is whether, under the origin of litigation rule, expenses incurred in regard to sales or other disposals of properties by a liquidating corporation, relate to the original sale or transaction which created the claim, or must be related solely to the corporate liquidation. It would seem that the same origin of litigation rule would be applicable in both events.

The Fifth Circuit, in addition to citing cases in the areas mentioned above, relied upon decisions which determined the proper deductibility of litigation expenses incurred in litigations between stockholders and the liquidating corporation. As reflected by the Tax Court decision in Arthur H. DuGrenier, Inc., supra, the companion case to the Estate of Meade, the prevailing view of the Circuit Courts in regard to litigation expenses incurred by stockholders and the liquidating or redeeming corporation, in resolving disputes between the parties, is now controlled by this Court's decision in United States v. Gilmore, supra; Woodward v. Commissioner, supra; and United States v. Hilton Hotels Corporation, supra.

All of the cases in this area, which have been decided since the Supreme Court decisions in Woodward and Hilton, have applied the origin of litigation rule to this type of transaction and do not seem to be in conflict. See: Helgerson, et al v. United States, 426 F.2d 1293 (C.A. 8th Cir.

1970); Third National Bank in Nashville, et al v. United States, 427 F.2d 343 (C. A. 6th Cir. 1970); Ransburg v. United States, 440 F.2d 1140 (C.A. 10th Cir. 1971). The following cases decided prior to Woodward and Hilton seem to be in accord with the principles of this Court. See: Munson v. McGinnes, 283 F.2d 333, cert. denied 364 U.S. 880, 81 S.Ct. 171, 5 L.Ed. 2d 103 (C.A. 3rd Cir. 1960); Spangler v. Commissioner, 323 F.2d 913 (C.A. 9th Cir. 1963).

The above cases involved litigation between the stockholder and the liquidating corporation and do not seem to be applicable to the facts of this case.[4] In this case, the litigation is between the stockholder and a third party. The cases which appear more in point are the cases which involve litigation between a corporation and third parties in disposal of properties during corporate liquidations.

A. The deductibility of litigation expenses incurred by corporations in disposal of properties during corporate liquidations is in conflict among the Circuit Courts.

The decision of the Fifth Circuit relied

4/ The Fifth Circuit also cited the case of Munn, Jr. v. United States, 455 F.2d 1028, 197 Ct.Cl. 233 (1972). This is a Court of Claims case which involved the deductiblity of litigation expenses of a beneficiary against his trustee over sales of assets by the trustee. That court held that the origin of the litigation was the sale of the assets by the trustee, and the character of this sale must be allocated through the trust to the beneficiary. See: Case Note, 22 Journal of Public Law 223 (1973).

in part on cases which have determined the proper deduction of litigation expenses incurred in the sale of corporate assets by liquidating corporations. The issue in these cases is whether the deduction of the litigation expenses are to be included in the overall umbrella of the corporate liquidation, which would make the expenses an ordinary deduction, or whether the expenses must be allocated to the specific transaction which created the litigation expenses. This becomes especially important when the corporation has adopted a Sec. 337 plan of liquidation.

The Fifth Circuit Court cited the cases of United States v. Morton, 387 F.2d 441 (C.A. 8th Cir. 1968); Alphaco, Inc. v. Nelson, 385 F.2d 244 (C.A. 7th Cir. 1967); Towanda Textiles, Inc. v. United States, 180 F.Supp. 373, 149 Ct. Cl. 123 (1960). All of these cases involved the determination of the proper deductibility of litigation and other expenses incurred by a corporation in settling claims arising out of the destruction of the properties of a corporation during a Sec. 337 liquidation. The specific issue was whether the expenses were deductible as ordinary expenses of a corporate liquidation, or whether they should be offset against the Sec. 337 gain and, thereby, become nondeductible capital expenditures. The courts held in Morton, Alphaco, and Towanda Textiles that the deductibility of the expenses must relate to the specific transaction and not to the overall liquidation. The expenses were, therefore, nondeductible capital expenditures.

In addition to the cases cited in the opinion of the Fifth Circuit, the following Circuit Courts of Appeals have adopted the

view that legal expenses incurred in sales of assets during a corporate liquidation must relate to the sales transaction and are not deductible as an ordinary expense of the liquidation: the Third Circuit in Connery v. United States, 460 F.2d 1130 (C.A. 3rd Cir. 1972) adopted the opinion of the Seventh Circuit in Alphaco, Inc. v. Nelson, supra; the Sixth Circuit in Lanrao, Inc. v. United States, 422 F.2d 481 cert. denied 398 U.S. 928, 90 S. Ct. 1816 (C.A. 6th Cir. 1970); and, the Tax Court in Of Course, Inc., 59 T.C. 146 (1972).[5] The Tax Court in Of Course, Inc., supra, argued that the origin of litigation rule of this Court should be used to resolve this question.

A review of these decisions reflects that a majority of the Circuit Courts of Appeals believe that litigation expenses incurred by a corporation during corporate liquidations against third parties should be treated separately from the actual liquidation. These cases all hold in principle that the origin of the litigation is not the actual liquidation of the corporation, but the individual transaction which created the claim litigated.[6] It would seem that the

5/ This case is presently on appeal by the Commissioner to the Fourth Circuit.

6/ This is the position taken by most authorities. See: B. Bittker and J. Eustice, Federal Income Taxation of Corporations and Shareholders, 3d Ed., Sec. 11.65, p. 11-73: FN 135.
L. J. Barnett, "Deductibility of Attorneys' Fees: New Developments" 59 American Bar Association Journal, June, 1973, pp. 661-663.

same rule should apply in determining the deductibility of expenses of litigation by stockholders against third parties in regard to assets received in corporate liquidations.

The above cases are in direct conflict with the case of Pridemark, Inc. v. Commissioner, 345 F.2d 35 (C.A. 4th Cir. 1965), which holds that legal fees incurred in connection with the sale of assets during liquidations must be related solely to the corporate liquidation and are therefore properly deductible as ordinary expenses of corporate liquidations. The Tenth Circuit in United States v. Mountain States Mixed Feed Co., 365 F.2d [redacted] (C.A. 10th Cir. 1966) agrees with Pridemark.

In summary of these cases, it seems that the Third, Sixth, Seventh and Eighth Courts of Appeals, the Tax Court, and the Court of Claims would hold that the origin of the litigation incurred in sales of assets during corporate liquidations would be the specific transaction litigated; whereas, the Fourth and Tenth Circuits would hold that the origin of the litigation must be related to the overall liquidation of the corporation.

B. The deductibility of litigation expenses incurred by former stockholders in collecting claims received in corporate liquidations is now in conflict among the Circuit Courts of Appeals.

The decision of the Fifth Circuit is in direct conflict with the decision of the Second Circuit in Commissioner v. Doering, 335 F.2d 738 (C.A. 2nd Cir. 1964), which was decided on facts almost identical to this case. In Doering, the corporation had entered into litigation over a claim for

additional sums due the corporation under a contract providing for certain distributions of film rights. The corporation was liquidated and the individual stockholders received an undivided interest in this claim. The case was settled and the taxpayer received his share of the claim's proceeds after the deduction of his legal expenses. The taxpayer reported the proceeds received as a capital gain under Sec. 331, and deducted the legal expenses under Sec. 212(1) as an ordinary deduction.

The question in issue was whether the expenses were deductible under Sec. 212(1) or related solely to the corporate liquidation. The Second Circuit in Doering held that the expenses were properly deductible and the controlling factor in the deductibility of these expenses was how the expenses would have been deducted by the taxpayer's corporation. The Court stated, 335 F.2d 738, 740, "'Collection of Income' would seem to have been the precise purpose for which the fees were paid. Argosy's claim against Republic did not arise from the sale of a capital asset but from the grant of the right to distribute and exhibit its films."

The Fifth Circuit in its decision attempted to distinguish Doering from the facts in this case by stating that the legal expenses in Doering were incurred to collect sums due to the taxpayer under a fully executed and enforceable contract, but in this case, the transaction was not consummated until the claim against Kaiser had been settled. This distinction seems to be without merit. If the Fifth Circuit's theory is adopted, and the origin of litigation rule relates only to the corporate liquidation, then all litigation expenses incurred in collecting a claim received in a corporate

liquidation would be capital in nature. This would be applicable regardless of whether the legal expenses were for the collection of sums due the taxpayer under a completed contract or any other type of claim. The Doering case can not be reconciled with the Fifth Circuit's origin of litigation rule.

SUMMARY

A resolution of the specific issue in this case will have substantial impact on the deductibility of litigation expenses, not only in corporate liquidations, but also in corporate mergers, reorganizations or other separations. There is not a single corporate transaction which does not have some association with this problem. In addition, the same rule will be helpful in resolving conflicts in other areas such as transfers by estates and trusts.

This Court needs to resolve the conflicts among the various Circuits as to the proper deductibility of expenses in relationship to corporate liquidations. A resolution of this conflict requires the expansion of this Court's origin of litigation rule. It would seem logical to adopt the rule followed by the Tax Court in this case that the origin of the litigation in these instances relate to the original transactions which created the litigation and not to the method by which the assets was acquired.

In view of this Court's considerable effort in establishing rules to determine the deductibility of litigation expenses, it would be unfortunate if the origin of litigation rule is allowed to deteriorate by a misapplication of its principles. The Supreme Court needs to express its opinion on this matter and the writ of certiorari should be granted.

CONCLUSION

For the foregoing reasons, it is respectively submitted that the petition for certiorari should be granted.

J. Gilmer Blackburn
P. O. Box 757
Decatur, Alabama 35601

CERTIFICATE OF SERVICE

I hereby certify that on the _____ day of _____, 1974, three copies of the Petition for Writ of Certiorari were mailed, postage prepaid, to Scott P. Crampton, Assistant Attorney General, Department of Justice, Washington, D. C., Counsel for the Respondent. I further certify that all parties required to be served have been served.

_____

J. Gilmer Blackburn
P. O. Box 757
Decatur, Alabama 35601

Counsel for Petitioners

ESTATE of Joseph M. MEADE, Deceased, First National Bank of Florence, Executor, and Hazel B. Meade, Petitioners-Appellees,

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent-Appellant.

William S. and Elizabeth KING, Petitioners-Appellees,

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent-Appellant.

No. 73–1456.

United States Court of Appeals, Fifth Circuit.

Feb. 7, 1974.

Appeal by the Commissioner of Internal Revenue from a Tax Court ruling in favor of taxpayers in a proceeding for redetermination of income tax deficiencies. The Court of Appeals, Ainsworth, Circuit Judge, applying the "origin of the claim" test, held that attorney's fees paid by stockholders of a liquidated corporation in connection with settlement of an antitrust treble damage claim of the corporation which had been distributed pro rata with its stock in liquidation were not deductible as ordinary and necessary business expenses or expenses for the production of income, but must be capitalized and offset against long-term capital gain realized by the stockholders from settlement of the claim.

Reversed.

Synopses, Syllabi and Key Number Classification
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1. Internal Revenue ⇐409.2

Where stockholders of liquidated corporation received as part of liquidation proportionate shares of corporation's antitrust treble damage claim against another company, which claim had no ascertainable fair market value at time of distribution in liquidation, liquidation remained open transaction for tax purposes and amounts subsequently received from antitrust claim related back to initial exchange and were taxable as capital gain. 26 U.S.C.A. (I.R.C.1954) § 331.

2. Internal Revenue ⇐550.1

Expenses incurred by shareholders in effecting liquidation of their corporation ordinarily constitute capital expenditures which enter into computation of gain or loss arising from distribution. 26 U.S.C.A. (I.R.C.1954) §§ 162(a), 212, 263, 331.

3. Internal Revenue ⇐543

Where stockholders of liquidated corporation received in liquidation pro rata shares of corporation's treble damage antitrust claim against second company, the claim having no ascertainable fair market value at time of its distribution, legal expenses thereafter incurred by shareholders in settling claim were, under "origin of the claim" test, to be capitalized and offset against long-term capital gain realized from settlement, and could not be deducted from stockholders' ordinary income as ordinary and necessary business expense or expense incurred for production of income. 26 U.S.C.A. (I.R.C.1954) §§ 162, 162(a), 212, 212(1), 263, 702(b), 7482.

4. Internal Revenue ⇐566

Origin of claim with respect to which litigation expenses were incurred, rather than its potential consequences upon fortunes of taxpayer, is controlling basic test of whether expense was "business" or "personal" and, hence, whether it is deductible as expense incurred for conservation of property held for production of income. 26 U.S.C.A. (I.R.C.1954) §§ 162(a), 212, 263.

5. Internal Revenue ⇐543

"Origin of the claim" test is applicable not only to acquisition of capital asset but also in determining whether legal expenses are incurred in process of disposition of property. 26 U.S.C.A. (I.R.C.1954) §§ 162(a), 212, 263.

Appeals from the Decisions of the Tax Court of the United States (Alabama Case).

Before GEWIN, AINSWORTH and MORGAN, Circuit Judges.

AINSWORTH, Circuit Judge:

Taxpayers[1] incurred legal expenses in connection with the settlement of a civil antitrust claim that had been assigned to them in pro rata shares as distributees in a corporate liquidation. These cases present the question whether the legal expenses are deductible from ordinary income under section 212 of the Internal Revenue Code of 1954, or whether, under section 263 of the Code, they must be capitalized and offset against long-term capital gain realized by taxpayers from the settlement.

The pertinent facts have been fully stipulated. Joseph M. Meade and William S. King were the sole shareholders of the Alabama Wire Company, Inc. In 1963, that corporation and its wholly owned subsidiary employed an Atlanta, Georgia, law firm to advise whether Kaiser Aluminum and Chemical Corporation, in connection with its dealings with Alabama Wire and its subsidiary, had violated the federal antitrust laws. For this initial employment, which ceased in early 1964,

1. Taxpayers are the Estate of Joseph M. Meade, deceased, and Hazel B. Meade, his widow, and William S. King and Elizabeth King, husband and wife. After this litigation was initiated, Joseph Meade died, and his estate was substituted as a party in this proceeding. Taxpayers' wives are parties because joint income tax returns were filed in 1966.

As used herein, the term taxpayers refers to Joseph M. Meade and William S. King.

the Atlanta firm was paid legal fees by Alabama Wire and its subsidiary.

The name of Alabama Wire was thereafter changed to Terrace Corporation, and, on February 15, 1965, the corporation was liquidated. Among the proceeds of the liquidation was the potential claim against Kaiser Aluminum, which, the parties have stipulated, had no ascertainable value at that time. Meade and King, individually, thus acquired ownership of the potential antitrust claim. Meade received a one-third interest in the claim, and King received a two-thirds interest, in accordance with their proportionate ownership of the distributing corporation.[2]

Based upon a later opinion of Atlanta counsel, Meade and King, in 1965, retained the firm to pursue the antitrust claim on their personal behalf. An agreement was entered whereby the firm would be paid a monthly retainer fee plus 20 per cent of any amount recovered. When it was subsequently determined that San Francisco counsel should be employed to bring the suit against Kaiser Aluminum in California, the agreement was modified to provide that a retainer of $10,000 would be paid to San Francisco counsel (which amount was to be credited against future retainer charges due Atlanta counsel), and that both counsel would share a 33 per cent participation in any amount recovered.

Suit was brought against Kaiser Aluminum in 1965 in the names of Meade and King, individually, as assignees of the cause of action of Alabama Wire and its subsidiary. Treble damages of $9,000,000 were sought. The case was settled in 1966 for $900,000, of which Meade received $300,000, and

2. The record indicates that on the day following the liquidation of Terrace Corporation taxpayers transferred their respective interests in the antitrust claim to a partnership owned by them in the same proportions. The partnership filed a U. S. Partnership Return of Income for the taxable year 1966. Because in these circumstances the partnership was a mere conduit for tax purposes, its existence is not material to our analysis or decision in this case. *See* section 702(b) of the Internal Revenue Code of 1954.

King, $600,000. On his respective 1966 income tax return, each reported the proceeds of the settlement as additional long-term capital gain from the liquidation of Terrace Corporation.

Pursuant to the aforementioned agreement with counsel, Meade and King, in 1966, paid legal fees and litigation expenses totaling $320,993.67.[3] Meade paid one third of that amount, and King paid two thirds. Each claimed the full amount so paid by him as a deduction against ordinary income on his 1966 tax return. The Commissioner disallowed these deductions and treated the entire amount of legal expenses as an offset against the long-term capital gain realized by taxpayers from their antitrust claim. This resulted in an asserted deficiency for the taxable year 1966 in the amount of $29,991.37 for Meade and $65,221.26 for King. Taxpayers filed petitions with the Tax Court for a redetermination of their deficiencies. Upon the consolidation of the cases, the Tax Court held that the attorneys' fees and expenses are properly deductible under section 212(1) as payments for the production of income. 31 CCH Tax Ct.Mem. 935 (1972). This Court has jurisdiction under section 7482 of the Internal Revenue Code of 1954. We reverse the decision of the Tax Court.

[1] The stock of Terrace Corporation constituted a capital asset in the hands of the taxpayers of Terrace Corporation. Thus, the proceeds of the liquidation of Terrace Corporation, received in exchange for their Terrace stock, constituted capital gain to taxpayers. Since the antitrust claim was included as part of the proceeds of the liquidation, the fair market value of the claim ordinarily would have entered into the computation—made at that time—of taxpayers' capital gain from the liquidation. *See* section 331 of Internal Revenue

3. Meade and King paid from a joint bank account a total of $56,326.67 for monthly advances for legal fees and expenses. The remainder of the fees previously agreed to, which amounted to $264,667, was paid following settlement of the suit.

Code of 1954. In this instance, however, the potential claim had no ascertainable fair market value at the time of distribution, and no value was assigned to it for purposes of computing taxpayers' capital gain from the liquidation. The liquidation therefore remained an "open transaction," and, for tax purposes, the amounts subsequently received from the antitrust claim related back to the initial exchange. See Burnet v. Logan, 283 U.S. 404, 51 S.Ct. 550, 75 L.Ed. 1143 (1931); Dennis v. C.I.R., 5 Cir., 1973, 473 F.2d 274, 285; C.I.R. v. Carter, 2 Cir., 1948, 170 F.2d 911; Westover v. Smith, 9 Cir., 1949, 173 F.2d 90. It being undisputed that the Terrace stock was a capital asset in taxpayers' hands, taxpayers and the Commissioner agree that taxpayers had long-term capital gain upon the settlement with Kaiser Aluminum in 1966.

This appeal involves the treatment of taxpayers' legal expenses in connection with the settlement of the antitrust claim. Taxpayers contend that these legal expenses are deductible from ordinary income as expenses incurred "for the collection of income" under section 212(1). The Commissioner argues that the legal expenses must be capitalized and offset against taxpayers' capital gain because they were incurred in connection with the disposition of a capital asset, the Terrace Corporation stock, within the meaning of section 263.

[2] Section 162(a) of the Code permits an individual or corporate taxpayer to deduct all ordinary and necessary expenses paid or incurred in carrying on a trade or business.[4] Section 212 permits an individual not engaged in a trade or business to deduct similar expenses paid or incurred "for the production or collection of income" and "for the management, conservation, or maintenance of property held for the production of income."[5] The concept of capital expenditures, on the

4. Section 162(a), 26 U.S.C. § 162(a), provides in pertinent part:

§ 162. Trade or business expenses

(a) In general.—There shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business . . . .

5. Section 212, 26 U.S.C. § 212, provides:

other hand, limits the deductions permitted for such gain-seeking expenses under sections 162 and 212.[6] Although section 263, which deals with capital expenditures, explicitly denies a deduction only for certain types of expenditures,[7] it is clear that the section does not provide an exclusive list. C.I.R. v. Lincoln Savings and Loan Association, 403 U.S. 345, 358, 91 S.Ct. 1893, 1901, 29 L.Ed.2d 519 (1971). The limits of nondeductibility for capital expenditures are found in the case law. Here, we are guided by fundamental doctrine recently noted by the Supreme Court in Woodward v. C.I.R., 397 U.S. 572, 575, 90 S.Ct. 1302, 1305, 25 L.Ed.2d 577 (1970): "It has long been recognized, as a general matter, that costs incurred in the acquisition or disposition of a capital asset are to be treated as capital expenditures."[8] More specifically, expenses

§ 212. Expenses for production of income

In the case of an individual, there shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year—

(1) for the production or collection of income;

(2) for the management, conservation, or maintenance of property held for the production of income; or

(3) in connection with the determination, collection, or refund of any tax.

6. For purposes of this distinction between capital expenses and ordinary expenses, sections 162 and 212 are construed in the same manner, with the exception that section 212 permits deductions "for the ordinary and necessary expenses of nonbusiness profitmaking activities." Woodward v. C.I.R., 397 U.S. 572, 575 n. 3, 90 S.Ct. 1302, 1305 n. 3, 25 L.Ed.2d 577 (1970).

7. Section 263, 26 U.S.C. § 263, provides in part:

§ 263. Capital expenditures

(a) General rule.—No deduction shall be allowed for—

(1) Any amount paid out for new buildings or for permanent improvements or betterments made to increase the value of any property or estate. . . .

8. *See, e. g.*, Spreckels v. Helvering, 315 U.S. 626, 62 S.Ct. 777, 86 L.Ed. 1073 (1942); Helvering v. Winmill, 305 U.S. 79, 59 S.Ct. 45, 83 L.Ed. 52 (1938); Helgerson v. United States, 8 Cir., 1970, 426 F.2d

incurred by shareholders in effecting the liquidation of their corporation—our concern in this case—ordinarily constitute capital expenditures, which enter into the computation of gain or loss arising from the distribution. *See, e. g.*, Third National Bank v. United States, 6 Cir., 1970, 427 F.2d 343; Helgerson v. United States, 8 Cir., 1970, 426 F.2d 1293; Estate of McGlothlin v. C.I.R., 5 Cir., 1967, 370 F.2d 729.

The Supreme Court's recent decisions in Woodward v. C.I.R., *supra*, and its companion case, United States v. Hilton Hotels Corporation, 397 U.S. 580, 90 S.Ct. 1307, 25 L.Ed.2d 585 (1970), shed further light on the principles applicable to this appeal. In those cases, the Court unanimously held that expenses of litigation that arise out of the acquisition of a capital asset are capital expenses. The cases presented two substantially identical situations. Taxpayers incurred legal expenses in appraisal proceedings in connection with a purchase of dissenting shareholders' stock that was required under local law. Taxpayers argued that the "primary purpose" test should be applied in determining the deductibility of the costs of acquiring or disposing of property. That rule, developed in the context of expenditures to defend or perfect title to property, provides that such expenditures are capital in nature only where the taxpayer's primary purpose in incurring them is to defend or perfect title. *See, e. g.*, Treas.Reg. on Income Tax § 1.263(a)–2(c); Rassenfoss v. C.I.R., 7 Cir., 1946, 158 F.2d 764; Industrial Aggregate Co. v. United States,

1293, 1296; Spangler v. C.I.R., 9 Cir., 1963, 323 F.2d 913, 918–919; Alphaco, Inc. v. Nelson, 7 Cir., 1967, 385 F.2d 244; Treas.Regs. on Income Tax § 1.263(a)–2(e). *See also* United States v. Mississippi Chemical Corp., 405 U.S. 298, 92 S.Ct. 908, 31 L.Ed.2d 217 (1972); C.I.R. v. Lincoln Savings & Loan Association, 403 U.S. 345, 91 S.Ct. 1893, 29 L.Ed.2d 519 (1971); Pacific Transport Co. v. C.I.R., 9 Cir., 1973, 483 F.2d 209.

The Commissioner acknowledges, however, that not all expenses attributable to capital assets are necessarily required to be capitalized, *see* Treas.Regs. on Income Tax § 1.212–1(b); nor are they necessarily deductible, *see* Treas.Regs. on Income Tax §§ 1.212–1(k) and (n), and 1.263(a)–2.

8 Cir., 1960, 284 F.2d 639, 645. The primary purpose of their expenditures in the appraisal proceedings, taxpayers argued, related not to the acquisition of title, but to the price to be paid for the stock, and, therefore, their expenditures should not be characterized as acquisition costs.

In rejecting the taxpayers' claims in *Woodward* and *Hilton Hotels,* the Supreme Court found the primary purpose test inapplicable to the situations before it: "A test based upon the taxpayer's 'purpose' in undertaking or defending a particular piece of litigation would encourage resort to formalisms and artificial distinctions." Woodward v. C.I.R., 397 U.S. at 577, 90 S.Ct. at 1306. Instead, the Court adopted the "origin" test, choosing to consider the origin and character of the claim for which the expenditures were made. On the basis of that test, the Court held that the determination of a purchase price by litigation is clearly part of the process of acquisition and should be treated as part of the cost of the stock that the taxpayers acquired. In so holding, the Court noted that "ancillary expenses incurred in acquiring or disposing of an asset are as much part of the cost of that asset as is the price paid for it." Woodward v. C.I.R., 397 U.S. at 576, 90 S.Ct. at 1305.[9] We find the Court's reasoning compelling in its application to the facts before us.

[3] As we noted above, the exchange in the liquidation of taxpayers' stock for the Terrace assets resulted in capital gain treatment to the taxpayers. The exchange remained an open transaction until the proceeds of the antitrust claim were collected by taxpayers. Since the open transaction event qualified for capital gain treatment, the amounts ultimately collected from the settlement do also. In effect, the proceeds of the settlement constituted additional consideration for tax-

9. The chief distinction between *Woodward* and *Hilton Hotels* was that in the latter case, under local law, taxpayers had received title to the dissenters' stock prior to the appraisal litigation, whereas in *Woodward* title passed after the litigation. The Court found the distinction to be of no consequence. United States v. Hilton Hotels Corporation, 397 U.S. at 584, 90 S.Ct. at 1309.

payers' stock in Terrace Corporation. While taxpayers have agreed with the Commissioner that the liquidation should be kept open in order to include the proceeds of the settlement as capital gains, taxpayers seek to close that transaction for the purpose of characterizing the legal expenses involved as deductible expenses for the collection of income. The Supreme Court's "origin of the claim" test prevents us from agreeing with taxpayers.

[4] The "origin" test was first set forth by the Court in United States v. Gilmore, 372 U.S. 39, 83 S.Ct. 623, 9 L.Ed.2d 570 (1963). There it was held that legal expenses incurred by a taxpayer in defending a divorce suit were nondeductible personal expenses even though taxpayers' securities holdings, and possibly his business reputation, would be affected by the outcome of the case. The Court sustained the Government's position that deductibility depended on the "origin and nature" of the claim against the taxpayer, and found that the claim arose out of the personal relationship of marriage. The Court stated the proper test as follows: "[T]he origin and character of the claim with respect to which an expense was incurred, rather than its potential consequences upon the fortunes of the taxpayer, is the controlling basic test of whether the expense was 'business' or 'personal' and hence whether it is deductible or not under § 23(a)(2) [section 212 of the 1954 Code]." 372 U.S. at 49, 83 S.Ct. at 629. It was this test that the Court adopted in *Woodward* in determining that the origin of the particular litigation involved was found in the process of the acquisition of a capital asset, and that therefore the expenses of the litigation were nondeductible capital expenses.

[5] Although there is admittedly a distinction between the two situations, we think it clear that the Court adopted this test, not only with respect to the acquisition of a capital asset, but also for determining whether legal expenses are incurred in the process of *disposition* of property. *See* Woodward v. C.I.R., 397 U.S. at 576, 578 n. 7, 90 S.Ct. at 1305, 1306 n. 7;

Third National Bank v. United States, 6 Cir., 1970, 427 F.2d 343, 344; Munn v. United States, 1972, 455 F.2d 1028, 1033, 197 Ct.Cl. 233. Substantially the same problems arise in each determination. In both the disposition and acquisition of property, a determination must be made of the tax consequences of monetary outlays in connection with contesting the value of certain capital assets. The uncertainty and difficulty of considering the taxpayer's motive in incurring expenses are present in both situations. For the deductibility of payments to depend upon such subjective considerations would, as the Court noted in *Woodward*, encourage resort to "formalisms and artificial distinctions."

Applying the "origin" standard to the facts before us, we are convinced that the antitrust claim against Kaiser Aluminum—as it rested in the hands of these taxpayers—had its origin in the process of the disposition of their stock in Terrace Corporation. The claim was part of the Terrace assets received by taxpayers in the liquidation of the corporation, and taxpayers' disposition of their stock was an open transaction for purposes of the collection of the proceeds of the settlement. Thus, the valuation of the claim against Kaiser Aluminum was vital to the disposition of taxpayers' stock, and the litigation necessary for this determination was an integral part of the overall transaction. Hence, the expenses incurred in the litigation that led to the settlement are properly treated as part of the cost of the stock that the taxpayers exchanged in the liquidation.[10]

10. The result we reach in this appeal is in harmony with several decisions rendered prior to the *Woodward* and *Hilton Hotels* cases. *See, e. g.*, Munson v. McGinnes, 3 Cir., 1960, 283 F.2d 333, cert. denied, 364 U.S. 880, 81 S.Ct. 171, 5 L.Ed.2d 103; Spangler v. Commissioner, 9 Cir., 1963, 323 F.2d 913. *See also* United States v. Morton, 8 Cir., 1968, 387 F.2d 441; Alphaco, Inc. v. Nelson, 7 Cir., 1967, 385 F.2d 244; Towanda Textiles, Inc. v. United States, 1960, 180 F.Supp. 373, 377, 149 Ct.Cl. 123.

Our decision is also strongly supported by the case law subsequent to *Woodward* and *Hilton Hotels*. *See, e. g.*, Helgerson v. United States, 8 Cir., 1970, 426 F.2d 1293, 1297–1298; Third National Bank v. United States, 6 Cir., 1970, 427 F.2d 343; Anchor Coupling Co. v.

Taxpayers have directed our attention to two circuit court decisions, Naylor v. C.I.R., 5 Cir., 1953, 203 F.2d 346, and C.I.R. v. Doering, 2 Cir., 1964, 335 F.2d 738, which presented problems similar to the one before us. In *Naylor*, taxpayer gave an option to purchase certain stock, which was a capital asset in his hands, at a price based on the stock's net asset value shown on the books of the company on a certain date. The purchaser exercised his option, but thereafter a dispute arose over the valuation, and taxpayer hired an attorney to negotiate with the purchaser concerning the value of the shares. Taxpayer's expenses in connection with the valuation were held deductible under the predecessor of section 212(1).

Doering involved a fact pattern slightly different from *Naylor*. In *Doering*, taxpayer owned stock in Argosy Pictures Corporation, which had contracted to produce certain films for distribution by Republic Pictures Corporation. A dispute arose between the corporations as to the amount of Argosy's participation in the proceeds under the contract, but Argosy liquidated before a settlement was effected. Because the claim had no ascertainable fair market value at the time, the transaction remained "open" for tax purposes. In redemption of his stock, a capital asset, taxpayer received cash and a pro rata portion of Argosy's claim against Republic. Thereafter, in effecting a settlement of the dispute over the terms of Argosy's contract with Republic, taxpayer incurred legal expenses. The full Tax Court, four judges dissenting, allowed him to deduct the expenses under section 212 because they were incurred for the "collection of income." A divided panel of the Second Circuit affirmed.

We think that the *Naylor* and *Doering* decisions have been considerably eroded by *Woodward* and *Hilton Hotels*, which

United States, 7 Cir., 1970, 427 F.2d 429, cert. denied, 401 U.S. 908, 91 S.Ct. 866, 27 L.Ed.2d 806 (1971); Ransburg v. United States, 10 Cir., 1971, 440 F.2d 1140; Munn v. United States, 1972, 455 F.2d 1028, 197 Ct.Cl. 233; Clark Oil and Refining Corp. v. United States, 7 Cir., 1973, 473 F.2d 1217. *See also* 2[illegible] Public Law 233 (1973).

arrived at results different from *Naylor* and *Doering*, though all four cases presented similar fact situations. *See* Helgerson v. United States, 8 Cir., 1970, 426 F.2d 1293, 1298. *See generally* 4A Mertens, Law of Federal Income Taxation § 25A.15; B. Bittker & J. Eustice, Federal Income Taxation of Corporations and Shareholders 11–82 (1971). *Naylor* and *Doering* are, however, distinguishable from the Supreme Court decisions and from the cases before us.

We see *Naylor* as holding that if a disposition of a capital asset has been consummated, and subsequent controversy concerns no more than enforcement of the terms of the agreement, then the problem is one of collection of income under section 212. *See* Munson v. McGinnes, 3 Cir., 1960, 283 F.2d 333, 335, cert. denied, 364 U.S. 880, 81 S.Ct. 171, 5 L.Ed.2d 103. As the Court noted in *Naylor*, "[t]he situation called for the services of an attorney to collect the proceeds of a sale of a capital asset. Petitioner's attorney was employed after an enforceable contract of sale existed." 203 F.2d at 347. Similarly, *Doering* involved legal expenses that were found to be a cost of collecting sums due the taxpayer under "a fully executed and enforceable contract." 39 T.C. 647, 650.

In *Woodward* and *Hilton Hotels*, on the other hand, the problem was treated as one of the establishment of a purchase price in the acquisition of a capital asset. The transactions there were clearly considered incomplete until the litigation to set a purchase price had concluded. "The whole process of acquisition required both legal operations—fixing the price, and conveying title to the [stock] . . . . ." United States v. Hilton Hotels Corporation, 397 U.S. at 584, 90 S.Ct. at 1309. So also in the cases before us, we are concerned with transactions not consummated until the claim against Kaiser Aluminum had been settled. Establishment of the value of the antitrust claim was a contingency on which the finality of taxpayers' stock disposition depended. By contrast, in *Naylor* and *Doering*, fully enforceable agreements existed, and litigation involved only the interpretation and enforcement of those

agreements. Accordingly, the legal expenses involved in those cases may more easily fit within the concept of expenses incurred for the collection of income than taxpayers' expenses in the cases before us.[11]

Reversed.

11. Taxpayers also place some reliance on Petschek v. United States, 2 Cir., 1964, 335 F.2d 734, a case that the Supreme Court in *Woodward* referred to as "a borderline case [under the origin test] of whether legal expenses were incurred in the disposition of property." 397 U.S. at 578 n. 7, 90 S.Ct. at 1306 n. 7. In *Petschek*, taxpayer was permitted to deduct legal fees expended in prosecuting a claim for compensation against funds created by foreign governments after they had confiscated corporations in which taxpayer held stock. We think that case must be distinguished from the cases at bar because there taxpayer's property "had been confiscated long before the fees were paid and [taxpayer's] efforts were directed toward reimbursement rather than to recovery of the property itself . . . . ." 335 F.2d at 735. Consequently, under the "origin" test the legal expenditures are much less susceptible of relation back to the disposition of property—the confiscation—than are the fees incurred by taxpayers in the cases before us. *See* 335 F.2d at 736–737.

United States Court of Appeals

FOR THE FIFTH CIRCUIT

October Term, 19 73

No. 73-1456

T. C. Docket Nos. TC 2343-70; TC 2657-70
(Cons. in T.C.)

ESTATE OF JOSEPH M. MEADE, Deceased, FIRST NATIONAL BANK OF FLORENCE, EXECUTOR, and HAZEL B. MEADE,
Petitioners-Appellees,
versus
COMMISSIONER OF INTERNAL REVENUE,
Respondent-Appellant.

****

WILLIAM S. and ELIZABETH KING,
Petitioners-Appellees,
versus
COMMISSIONER OF INTERNAL REVENUE,
Respondent-Appellant.

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Appeals from the Decisions of the Tax Court of the United States (ALABAMA CASE)

Before GEWIN, AINSWORTH and MORGAN, Circuit Judges.

J U D G M E N T

This cause came on to be heard on the transcript of the record of the Tax Court of the United States, and was argued by counsel;

ON CONSIDERATION WHEREOF, It is now here ordered and adjudged by this Court that the decisions of the said Tax Court in this cause be, and the same is hereby, reversed;

It is further ordered that petitioners-appellees pay to respondent-appellant, the costs on appeal to be taxed by the Clerk of this Court.

February 7, 1974

Issued as Mandate:

IN THE UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

U. S. COURT OF APPEALS
FILED
MAR 5 1974
EDWARD W. WADSWORTH
CLERK

NO. 73-1456

ESTATE OF JOSEPH M. MEADE, Deceased,
FIRST NATIONAL BANK OF FLORENCE, EXECUTOR,
and HAZEL B. MEADE,

Petitioners-Appellees,

versus

COMMISSIONER OF INTERNAL REVENUE

Respondent-Appellant.

WILLIAM S. and ELIZABETH KING,

Petitioners-Appellees,

versus

COMMISSIONER OF INTERNAL REVENUE,

Respondent-Appellant.

PETITION FOR REVIEW OF DECISIONS OF THE
TAX COURT (Alabama Case)

ON PETITION FOR REHEARING

(March 5, 1974)

Before GEWIN, AINSWORTH and MORGAN, Circuit Judges.

PER CURIAM:

IT IS ORDERED that the petition for rehearing filed in the above entitled and numbered cause be and the same is hereby denied.

APPENDIX B

T. C. Memo. 1972-190

UNITED STATES TAX COURT

ESTATE OF JOSEPH M. MEADE, DECEASED, FIRST NATIONAL BANK OF FLORENCE, EXECUTOR, & HAZEL B. MEADE, Petitioners v. COMMISSIONER OF INTERNAL REVENUE, Respondent

WILLIAM S. AND ELIZABETH KING, Petitioners v. COMMISSIONER OF INTERNAL REVENUE, Respondent

Docket Nos. 2343-70
2657-70.

Filed August 29, 1972.

J. Gilmer Blackburn, for the petitioners.

Robert D. Hoffman, for the respondent.

Petitioners received as part of the proceeds from liquidation of a corporation a potential civil antitrust claim having no ascertainable fair market value. The claim was settled and petitioners deducted the attorneys' fees as expenses paid for the collection of income. Respondent determined such expenses to be an offset to the capital gain realized from settlement of the antitrust claim. Held, the expenses are deductible under section 212(1) I.R.C. 1954 as being paid for the production of income.

MEMORANDUM OPINION

GOFFE, Judge: Respondent determined deficiencies in the Federal income taxes of petitioners as follows:

Docket No.	Petitioner	Year	Deficiency
2343-70	Estate of Joseph Meade, Deceased, First National Bank of Florence, Executor, and Hazel B. Meade	1966	$29,991.37
2657-70	William S. King and Elizabeth King	1966	65,221.26

Upon joint motion by all the parties these cases were consolidated for trial, briefs and opinion. The sole issue for decision is whether legal fees paid by the petitioners for the purpose of pursuing a civil antitrust claim assigned to them in pro rata shares as distributees in a corporate liquidation are deductible under section 212 of the Internal Revenue Code of 1954.[1]

All of the facts have been stipulated. The stipulation of facts and exhibits attached thereto are incorporated herein and adopted as our findings.

Petitioner Estate of Joseph M. Meade, Deceased, First National Bank of Florence, Executor, is a successor petitioner to Joseph M. Meade who died on January 12, 1971, after the filing of the petition in docket No. 2343-70. Joseph M. Meade and his wife, Hazel B. Meade, were residents of Florence, Ala.

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1 All statutory references are to the Internal Revenue Code of 1954, as amended, unless otherwise indicated.

when the petition was filed. They filed their joint Federal income tax return for the taxable year 1966 with the director, internal revenue service center at Chamblee, Ga.

Petitioners William S. King and Elizabeth King, husband and wife, were residents of Florence, Ala. when they filed their petition herein. They filed their joint Federal income tax return for the taxable year 1966 with the director, internal revenue service center, Chamblee, Ga.

William S. King and Joseph M. Meade (hereinafter sometimes referred to as petitioners or King and Meade) were partners in the ratio of two thirds and one third respectively during the taxable year 1966 in a partnership named King and Meade. It filed a U.S. Partnership Return of Income for the taxable year 1966.

Meade and King were the sole stockholders of Terrace Corporation (formerly named Alabama Wire Company, Inc.), owning the outstanding stock in the ratios of one third and two thirds, respectively. They liquidated the corporation on February 15, 1965, and on the following day created the King and Meade partnership.

Alabama Wire Company, Inc. (hereinafter referred to as Alabama Wire) and its wholly owned subsidiary, Columbia Metal Products, Inc. (hereinafter referred to as Columbia Metal), in 1963 employed the law firm of Hansell, Post,

Brandon and Dorsey of Atlanta, Ga. to advise them whether Kaiser Aluminum & Chemical Corporation (hereinafter referred to as Kaiser Aluminum) had violated the Federal antitrust laws. Legal services performed by the firm included conferences with the clients and with the U.S. Department of Justice and the Federal Trade Commission in an attempt to bring about an investigation of Kaiser Aluminum. Alabama Wire and Columbia Metal paid the firm a total of $25,000 in legal fees in May and June of 1963. The efforts of the law firm in this pursuit ceased in early 1964.

When Terrace Corporation was liquidated, Meade and King received as a portion of the proceeds from the liquidation the potential claim which the corporation had against Kaiser Aluminum for treble damages resulting from possible violations of the Federal antitrust laws. The potential claim had no ascertainable fair market value at the time of distribution on February 15, 1965.

In mid-1965, the Hansell, Post, Brandon & Dorsey law firm rendered an opinion to Meade and King on the possibilities of their filing an action for treble damages against Kaiser Aluminum. Based on this opinion, Meade, King and the law firm agreed upon a fee arrangement whereby the law firm would receive from them a monthly retainer of $1,500 for the months of July, August and September, 1965, and thereafter

a monthly retainer of $750 until the matter was concluded; however, during the months of trial of the case the monthly retainer would be $2,000. In addition, Meade and King agreed to pay monthly all of the expenses of the firm in connection with the matter and an additional fee of 20 percent of the amount recovered from Kaiser Aluminum, if any.

It was later concluded that a civil suit should be instituted on behalf of Meade and King in the United States District Court in San Francisco, Cal. and that counsel located in San Francisco should be employed. Meade and King employed Mr. Joseph L. Alioto as such counsel with a $10,000 retainer. They also modified the fee arrangement with the Atlanta law firm whereby the monthly retainer would be discontinued until the retainer of $10,000 was paid to Mr. Alioto. In addition, the attorneys (both Atlanta and San Francisco) were given a 33 percent participation (collectively) in the recovery, if any.

In 1965, King and Meade individually as assignees of the cause of action of Columbia Metal and Alabama Wire, filed suit against Kaiser Aluminum in the United States District Court for the Northern District of California, Southern Division under sections 4, 12 and 16 of the Clayton Act (15 U.S.C. secs. 15, 22 and 26) to recover treble damages resulting from Kaiser Aluminum's alleged violations of

sections 1 and 2 of the Sherman Act (15 U.S.C. secs. 1 and 2).

The complaint in that suit contained allegations that Columbia Metal purchased aluminum ingots from Alcoa, Reynolds Metals Company and Kaiser Aluminum whose production constituted over 92 percent of the aluminum ingots produced in this country. From such ingots Columbia Metal manufactured aluminum rods which are drawn through dies to produce various sizes of wire which in turn is woven into screening. One type of rod manufactured by Columbia Metal was called Alclad Rod of which it sold its entire production to Alabama Wire. The parent corporation, Alabama Wire, at various times, sold some of the rods and further manufactured other rods into wire screening all of which it sold to various customers throughout the country. King and Meade further alleged that Kaiser Aluminum and Alcoa produced 88 percent of the Alclad Rod output and Columbia Metal produced the other 12 percent, such production constituting 50 percent of Columbia Metal's total output of aluminum rods. They alleged that Kaiser Aluminum and Alcoa conspired to set the price of the aluminum ingots at a high level and at the same time reduced the price of the finished product, Alclad Rods, thereby forcing Columbia Metal out of business. They alleged further that such practice of Kaiser Aluminum and Alcoa resulted in the loss of profits to Columbia Metal, destruction of its goodwill, and created a loss from

the sale of the business at a price which would have been higher had not the defendants committed the alleged acts. King and Meade alleged damages of $3,000,000 which, under the Sherman Act, produced threefold damages of $9,000,000.

The suit against Kaiser Aluminum was settled in 1966 for $900,000 which was paid $600,000 to King and $300,000 to Meade. They reported these amounts on their respective income tax returns for 1966 as additional long-term capital gain realized by them from the liquidation of Terrace Corporation. Respondent has not challenged the tax treatment of the $900,000 recovery.

During 1966, King and Meade paid out of their joint bank account a total of $56,326.67 for monthly advances of attorney fees and expenses of the litigation against Kaiser Aluminum. These expenditures were allocated $37,551.12 to King and $18,775.55 to Meade. Following settlement of the suit, Meade and King paid the remainder of the attorneys' fees previously agreed to, $177,778 by King and $86,889 by Meade. They each deducted all the fees and legal expenses paid in 1966 on their respective Federal income tax returns for that year as Miscellaneous Deductions under Part IV.

Respondent determined that King's and Meade's respective shares of the partnership profit should be adjusted by disallowing the legal fees and expenses as a deduction

under section 212,[2] but allowing them as offsets to the long-term capital gains reported by each resulting from settlement of the suit.

Petitioners rely on Otto C. Doering, 39 T.C. 647 (1963), affd. 335 F.2d 738 (C.A.2, 1964). The holding in Doering, supra, is that legal expenses paid to collect income, even though the income collected is capital gain, are deductible under section 212. Respondent argues that the facts in the instant case are distinguishable from those in Doering, supra. He contends that the claim which was distributed to the stockholders in Doering, supra, was an established claim and nothing remained to be done except to collect it, but in the instant case the claim distributed to Meade and King was a bare claim which contemplated legal fees to establish the claim and bring about collection. He concludes that such legal fees are analogous to liabilities assumed upon liquidation and, therefore, must be capitalized. We find no merit to such a distinction in facts. Our holding in Doering, supra, is based upon an analysis of the purpose for

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2 SEC. 212. EXPENSES FOR PRODUCTION OF INCOME.

In the case of an individual, there shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year --

(1) for the production or collection of income;

which the legal expenses were incurred. We found there that the expenses were incurred for the collection of income. Likewise we find such a purpose here. Such expenses are not tainted with the aspect of a capital expenditure because they were contemplated at the time the corporation was liquidated.

Respondent, after attempting to distinguish Doering, supra, argues that our opinion and that of the Court of Appeals for the Second Circuit in Doering are incorrect. We are unconvinced that the opinions in Doering are wrong. Respondent makes the same arguments here that he made in Doering. No useful purpose would be served by repeating them. We have continued to apply the rationale of Doering and can see no reason to abandon it here.

Respondent argues that petitioners should not prevail because they cannot satisfy the so-called "origin of the claim" test applied by the Supreme Court in United States v. Gilmore, 372 U.S. 39 (1963); Woodward v. Commissioner, 397 U.S. 572 (1970); and United States v. Hilton Hotels Corp., 397 U.S. 580 (1970). We conclude that respondent fails when such test is applied. That test requires inquiry into the origin and character of the claim which is the subject of litigation. Respondent admits that if the corporations (Alabama Wire and Columbia Metal) had received the $900,000, it would constitute income. The character of the claim is, therefore, collection

of income. Its origin was the alleged violations of the antitrust laws by Kaiser Aluminum. By "origin" of the claim we do not construe that to mean how the claim was acquired by the taxpayers who pursue it but instead we conclude that it means the event which gave rise to the claim. United States v. Gilmore, supra.

We do not believe that a transformation of the tax treatment of the realization on the claim from ordinary income to capital gain brought about by the corporate liquidation changes the origin and character of the claim. It remains a claim for the collection of income.

It follows, therefore, that the attorneys' fees and expenses are deductible under the provisions of section 212(1).

Decisions will be entered for the petitioners in docket Nos. 2343-70 and 2657-70.